

EXHIBIT B



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Wells Fargo Convertible Bonds

In April 2003, Howard Atkins, chief financial officer of Wells Fargo & Company (Wells Fargo or the company), was considering the issuance of a convertible debt security. Although the firm had tapped the capital markets for \$23 billion in 2002, this particular issue would be the first of its kind in the company's 151-year history. Atkins had just concluded a meeting with a group of investment bankers, including Kevin Woodruff and Scott Greenberg of Morgan Stanley. He now wondered if he should recommend the transaction to Wells Fargo's chief executive officer, Dick Kovacevich. (See Exhibit 1 for management biographies on Kovacevich and Atkins.)

Wells Fargo

Wells Fargo was headquartered in San Francisco, California, with \$349 billion in assets as of year-end 2002. Fiscal 2002 net interest income totaled \$14.9 billion and net income totaled \$5.4 billion. (See Exhibit 2, 3, and 4 for Wells Fargo's financial statements.) Wells Fargo provided a variety of financial services, including banking, insurance, mortgage banking, and consumer finance. Retail, corporate, and commercial banking services were provided through bank subsidiaries in 23 states.¹ Wells Fargo ranked fourth in assets and third in market capitalization among bank holding companies in the U.S.,² and was one of the largest lenders to small businesses in the country. The company had roughly 20 million customers, 5,000 branches, and 127,500 full-time equivalent employees.

Financing Strategy

As of early 2003, Wells Fargo's credit ratings were among the strongest of any financial services company. Its subsidiary, Wells Fargo Bank, was also one of the highest rated banks in the country. Customer deposits funded the bulk of Wells Fargo's assets; the remaining assets were funded by debt and other borrowings. On average, the company rolled over approximately \$30 billion in debt each year. (See Exhibit 5 for a breakdown on Wells Fargo's long-term debt.) The company's 2002 annual

¹ According to the company's annual report, the company's businesses broke down as follows: community banking (40%), investments and insurance (15%), home mortgage/home equity (13%), specialized lending (12%), wholesale banking (10%), consumer finance (6%), and commercial real estate (4%). Wells Fargo & Company Annual Report 2002, p. 30.

² Financial or bank holding companies were those that had controlling interests in one or more banks. As such, they were required to register with the Federal Reserve System under the Bank Holding Company Act of 1956.

Professor Malcolm Baker and Senior Researcher Liz Kind prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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report described its approach to capital management, "The objective of effective capital management is to produce above market long-term returns by opportunistically using capital when returns are perceived to be high and issuing/accumulating capital when such costs are perceived to be low."³ Atkins elaborated:

Given the fact that we are so large and prominent in the capital markets, we have the flexibility to be opportunistic. Although we watch the markets day in and day out, we are not actively issuing on a daily basis. Typically, we try to gain some sort of economic advantage by issuing debt instruments where demand is highest. Rather than having a predetermined notion and dictating exactly what we want to be issuing, we wait for the right opportunity.

The dealers at the investment banks act as our eyes and ears on the market. They contact us almost daily to keep us abreast of what's going on in the capital markets and where demand is strongest. Investor preferences change from one day to the next—sometimes it's one-year CD notes, other times it's ten-year subordinated notes, and other times it's convertible debt securities. Anything is on the table for us, but the starting point when we're talking to the dealers is, "Where is the demand?" My frame of reference is to determine when I am in a seller's market rather than a buyer's market.

We can afford to be opportunistic for several reasons. First, we have a huge core of deposits flowing through on a daily basis to fund the bank. Second, we issue in size when the demand is there. Third, we actively manage our positions in the derivatives market, which is much more liquid than the market for new issues. If the characteristics of what investors want don't happen to match what Wells Fargo needs, we still take advantage of market demand and do the issue, but then swap it through the derivatives market. For example, if investors are interested in ten-year fixed rate Wells Fargo subordinated notes and we don't want to be locked into ten-year fixed rate debt, we'll issue the debt anyway—that's where we're getting the economic advantage—but then we'll swap the ten-year debt back to a shorter maturity. That enables us to separate the liquidity decision from the currency and interest rate risk management decisions, while taking advantage of those sweet spots where demand for our paper is strongest.

As a bank and financial services holding company, Wells Fargo faced a number of funding constraints. The company and its subsidiary banks were subject to regulation by a number of agencies including the Federal Reserve Board, the Office of the Controller of the Currency and the Federal Deposit Insurance Corporation (FDIC). The agencies imposed quantitative measures—minimum ratios of capital to risk-weighted assets—to ensure capital adequacy. (See Exhibit 6 for leverage ratios for Wells Fargo and its banking subsidiaries.) Atkins commented, "All banks have their own target capital ratios, guided by the regulatory agencies. There are minimum regulatory capital requirements, but like most banks, we want to be well capitalized, with capital ratios well above the minimums."

Wells Fargo also faced constraints with regard to the transfer of funds between the bank and the parent company. Atkins explained:

In most companies, funds can flow back and forth between subsidiaries. With banks and bank holding companies, they can't. The Fed's source-of-strength doctrine places limits on the amount of money subsidiary banks can send upstream to their holding companies. Bank holding companies are required to act as a source of financial and managerial strength to their subsidiary banks, and FDIC insured deposits cannot fund holding company assets. As a result,

³ Wells Fargo & Company Annual Report 2002, p.53.

the process of managing liquidity at the holding company level becomes really, really important. Capital ratios are assessed on a consolidated basis, but liquidity needs to be managed both on a consolidated basis and specifically in the holding company.

Finally, Wells Fargo needed to take rating agency concerns into account in managing its capital. The rating agencies frowned upon parent companies issuing debt and then advancing it to their operating entities in the form of equity.

Atkins elaborated on the kinds of securities Wells Fargo was interested in issuing:

With regard to maturity, we look at the whole asset/liability structure of the company's balance sheet. We're not a big issuer of commercial paper. Liquidity is so important in the holding company that we don't want to be in the position of having to roll over overnight and three-month commercial paper. It is actually no more expensive for us to issue two- or three-year debt and swap it back to three-month interest rate maturity. We are able to get the liquidity without incurring any additional costs because of our financial strength. In turn, it is our long-standing financial strength that has enabled us to become one of the highest rated banks in the country.

Wells Fargo issued a variety of debt securities, ranging from two- to three-year senior notes to 10- to 12-year senior or subordinated debt. The company's finance team considered virtually any type of instrument depending upon market supply and demand trends, with the knowledge that the instrument could be swapped, if needed. Atkins noted, "With regard to interest rate risk, we are relatively neutral. Typically, we really don't want to be taking a view on interest rates."

The Market for Convertible Securities

Historically, convertible securities had been issued by firms with less than investment-grade credit. Scott Greenberg, executive director at Morgan Stanley, elaborated:

In the past, the typical convertible issuer was a non-investment grade technology or telecom company who wasn't a traditional straight debt issuer. The issuer generally chose convertibles for one of three reasons. One possibility was that the firm wanted to issue equity, but didn't have a registration statement available, and could take advantage of a convertible exemption under Rule 144A.⁴ A second possibility was that the firm thought that the conversion option was likely to be exercised, making convertibles cheaper than equity. A third possibility was that the firm thought that the convertible would not be exercised, making convertibles cheaper than debt.

Investment grade companies usually found cheaper funds by taking bank loans or issuing corporate bonds. However, in 2002, the market for convertible securities began to change. The Nasdaq crash of 2000 had created financial pressure for traditional convertible bond issuers. At the same time, investors in convertible securities—hedge funds specializing in convertible arbitrage⁵, long-only convertible funds, and some equity income funds—grew dramatically. By 2002, convertible arbitrage funds, then the chief buyers of convertible securities, were the fastest growing segment of

⁴ The Securities and Exchange Commission (SEC) adopted Rule 144A to improve the liquidity and efficiency of the private placements market. The rule allows qualified institutional buyers to trade certain restricted securities among themselves. Such restricted securities were exempt from the registration requirements of the Securities Act of 1933.

⁵ A convertible arbitrage fund typically bought convertibles, hedging their long positions with short positions in the issuers' common stock.

the hedge fund industry, with about \$50 billion of net investments.⁶ (See Exhibit 7 for returns on convertible arbitrage.)

As a result of the decline in technology and telecom stocks, convertible bond investors found themselves heavily weighted in non-investment grade securities. Eager to diversify, interest in investment grade convertibles grew. New product structures—from zero coupon convertibles to mandatory convertibles—provided a spectrum of convertible instruments that began to attract a variety of issuers.

The U.S. convertible market grew from \$161 billion in 1998 to \$235 billion in 2002, with a peak of \$252 billion in 2001.⁷ Demand for convertible issues was strong, stock price volatility was high, and the bond market was thriving. By 2003, a wide variety of companies—growth firms, members of the S&P 500, and companies undergoing restructuring—had convertibles outstanding. In early 2003, a new category of “hyper” or high premium convertible debt emerged where the conversion price was significantly greater than that of the market price of the underlying stock. Several companies, including Affiliated Managers and Mandalay Resort Group launched high premium convertible debt issues during the first quarter of 2003. (See Exhibit 8 for selected deal terms.)

Structuring the Convertible Bonds

Atkins explained the background behind the idea for Wells Fargo to issue a convertible security:

Within the last four or five months, a number of investment banks approached us, pitching convertible debt. Each of the banks presented a slightly different form for the proposed transaction. I was intrigued and took some time to understand the quirky tax and accounting issues associated with convertibles. As the dealers called me to tell me investors were screaming for the deal, I did something I’m told is very unusual. I got three of the firms—Merrill Lynch, Morgan Stanley, and Goldman Sachs—in a room at the same time. I said, “Guess what. The three of you are sitting in this room with me and my people and we’re not leaving until we come up with the terms that would make the most sense for Wells Fargo.” After their jaws dropped, everyone became aligned and focused on creating the best deal for Wells Fargo. It took all afternoon and well into the evening, but we came up with a structure that we could all agree on.

As a result of the meeting, Atkins was considering issuing \$3 billion of 30-year floating rate convertible debt. Interest would be paid at an annual rate of LIBOR minus 25 basis points. Concerned that the probability of conversion be kept low, Atkins sought to structure the security with a very high conversion premium. The securities would become convertible into Wells Fargo common stock only if the stock price exceeded \$120 before May of 2008.⁸ To allow for such a high premium, the bankers opted for a “convertible plus warrants” structure. Once convertible, the bonds could be exchanged for 10 shares of Wells Fargo common stock, plus an additional number of shares that varied with the stock price. At the end of five years, if the stock price thresholds were not met, the debt would no longer be convertible. But, instead of giving investors the ability to put the bonds back

⁶ Andrew Barry, “HD Perfect Storm: Bond Market Maelstrom Could Swamp Wall Street,” *Barron’s*, August 4, 2003, p. 17.

⁷ Anand S. Iyer, Morgan Stanley Convertible Team, “*Convertible Securities Presentation: Introduction to the Convertible Market*,” p.4 as accessed at www.convertbond.com on July 5, 2005.

⁸ The conversion price on the bonds was \$100 and the trigger price for conversion was \$120. The higher threshold made these “contingent convertible” bonds.

to the company, the security would be remarketed and the coupon reset each year. In that way, the final maturity of the bonds would be thirty years later, in 2033. (See **Exhibit 9** for more detail on the terms of the proposed transaction.)

Tax Treatment

The IRS issued “contingent interest” regulations in 1996. Normally, companies would simply deduct the coupon payments on convertible bonds for tax purposes. But, provided the security had economically important contingency features, companies could take deductions at their long-term straight debt rate, even if the coupon they were paying was lower. In some cases, taxes could be deferred on the savings until the security matured. In Wells Fargo’s case, the proposed convertible would be treated as a contingent payment debt instrument, and investors would recognize taxable income in excess of the cash interest they received while the issue was still outstanding.

As of April 2003, three-month LIBOR was 1.3% and Wells Fargo management believed the company could raise long term, fixed rate debt at 5.8%. (The yield curve was steep at the time. See **Exhibit 10**.)

Accounting Treatment

Atkins was also concerned about the accounting treatment of the convertible bonds. As always, he wanted to ensure that the potential issue conformed with generally accepted accounting principals (GAAP). At the same time, he wanted to minimize the possibility of having the convertible bonds influence the share count, at least until the instrument was actually converted. Under GAAP, the issue would not change the fully diluted shares outstanding for Wells Fargo until the stock exceeded the trigger price of \$120. However, there was always some risk that the Financial Accounting Standards Board (FASB) or SEC could argue, after the security was issued, that the bonds should count toward diluted shares outstanding. Atkins commented, “We wanted to act very conservatively and, at the same time, reduce the potential for dilution risk. We proposed that if our stock price went up and investors wanted to convert, we could deliver cash instead of stock.” Similarly, if Wells Fargo stock increased beyond \$120 per share, and the underlying convertible shares became worth \$1,200, the company could reflect \$200 of dilution, rather than \$1,200.

Pricing

In contemplating the security, Atkins needed to balance what he thought of as a “tradeoff between theoretical dilution and interest expense.” The interest savings was easy to compute. Wells Fargo would normally pay LIBOR plus 20 basis points on vanilla, floating rate debt. The cost was harder to compute. The convertible carried the risk that the company’s stock price would increase from where it was currently trading—closing at roughly \$47.45 a share on April 25—to \$120 a share by 2008. (Trading in Wells Fargo options suggested this was an unlikely event. See **Exhibit 11** for options market data.⁹) Atkins noted:

While there was a risk that we could get very significantly diluted, we realized that if our stock price went from 50 bucks a share to 120 bucks a share within five years, people would be very happy about the appreciation in the stock. We realized we were probably prepared to

⁹ Measured with monthly returns, Wells Fargo’s volatility was around 30% over the previous five years and around 17% over the previous year. Also lowering the potential for stock price appreciation, Wells Fargo paid a dividend of \$0.30 per quarter.

risk dilution because the scenario in which the dilution would occur would be a scenario where a lot of people would be sitting on a very valuable stock.

Execution

Given the unique structure of the proposed convertible, Atkins and his investment banking team expected it would take a few weeks to draft the legal documents. Should they go ahead, the group planned to do the transaction as an "overnight deal." When Atkins felt the market conditions were right, he would initiate execution by contacting the bankers at the end of the business day. At that point, the final terms would be set, and the investment bankers would assume the risk of placing the securities. The bankers would send a preliminary prospectus in a broadcast email to their network of institutional investors. Early the following morning, the bankers would have a conference call to explain the terms and answer questions, and before the markets opened, the deal would be priced.

Most convertible debt issues were in the \$100 million to \$500 million range. (See Exhibit 12 for the rankings of convertible bond underwriters.) At \$3 billion, the investment bankers knew the Wells Fargo bonds might be difficult to place. Nonetheless, they recognized the significance of the deal. Greenberg noted, "We've done a lot of big deals, but this would be one of the most important ones we've ever done. In our business, if someone like Wells Fargo picks you to underwrite a deal, it's a big feather in your cap. With the convertible security we are proposing, the technical innovations alone would make this transaction noteworthy."

Decision

As Atkins headed home for the evening, he wrestled with his options. The proposed convertible could provide the company with a low cost source of funds, but there were risks. Atkins elaborated further on his concerns: "Theoretically, I could create the same risk/reward characteristics as the convertible by issuing plain vanilla debt and selling an option on our stock. When I thought about it that way, it didn't really make me feel wonderful about doing the deal and I started asking myself, 'Where's the beef on this thing?'"

At the same time, Atkins was confident that his strategy to require the investment banking firms to work together had created an ideal structure for the potential convertible issue.

Exhibit 1 Management Biographies for Kovacevich and Atkins**Richard M. Kovacevich—Chairman and CEO**

Kovacevich joined Wells Fargo as president and CEO in November 1998, after the Wells Fargo-Norwest merger and was named chairman in April 2001. Kovacevich was named CEO of Norwest Corporation in 1993 and chairman in 1995, after serving as president and COO since 1989. He joined Norwest in March 1986, as vice chairman, COO, and head of the banking group. Prior to joining Norwest, he was group executive and member of the policy committee at Citicorp and a division manager at General Mills. Kovacevich served as a board member for numerous corporations—Cargill, Inc., Cisco Systems, Inc. and Target Corporation—and nonprofit and regulatory organizations, including the Federal Reserve's Federal Advisory Council, the California Business Roundtable, the San Francisco Symphony, and the San Francisco Museum of Modern Art. He graduated from Stanford University where he earned his MBA, and his bachelor's and master's degrees in industrial engineering.

Howard Atkins—Executive Vice President and Chief Financial Officer

Atkins was responsible for Wells Fargo's financial management functions, including controllers, financial reporting, tax management, asset-liability management, treasury, investor relations, and corporate properties. Before joining Wells Fargo in 2001, he was executive vice president and chief financial officer of New York Life Insurance Company, responsible for financial management and information technology. Prior to joining New York Life in 1996, Atkins was CFO at Midlantic Corporation, where he helped design and oversee Midlantic's financial restructuring. He also spent 17 years at Chase Manhattan Bank, where he rose to corporate treasurer. During his tenure at Chase, Atkins was responsible for asset liability management, capital planning, funding and investments, and interest rate insurance products. Atkins was a member of the American Banker CFO Advisory Board, the Financial Executives Institute, and the conference Board. He was a director of Ingram Micro and the Asian Art Museum in San Francisco. Atkins received a bachelor of science degree in mathematics from City College, New York, and a master's degree in economics from Ohio State University.

Exhibit 2 Wells Fargo & Company—Consolidated Statement of Income

(in millions, except per share amounts)	Year Ended December 31,		
	2002	2001	2000
INTEREST INCOME			
Securities available for sale	\$ 2,424	\$ 2,544	\$ 2,671
Mortgages held for sale	2,450	1,595	849
Loans held for sale	252	317	418
Loans	13,418	14,461	14,446
Other interest income	288	284	341
Total interest income	18,832	19,201	18,725
INTEREST EXPENSE			
Deposits	1,919	3,553	4,089
Short-term borrowings	536	1,273	1,758
Long-term debt	1,404	1,826	1,939
Guaranteed preferred beneficial interests in Company's subordinated debentures	118	89	74
Total interest expense	3,977	6,741	7,860
NET INTEREST INCOME	14,855	12,460	10,865
Provision for loan losses	1,733	1,780	1,329
Net interest income after provision for loan losses	13,122	10,680	9,536
NONINTEREST INCOME			
Service charges on deposit accounts	2,179	1,876	1,704
Trust and investment fees	1,781	1,710	1,624
Credit card fees	920	796	721
Other fees	1,384	1,244	1,113
Mortgage banking	1,713	1,671	1,444
Insurance	997	745	411
Net gains (losses) on debt securities available for sale	293	316	(739)
Net (losses) gains from equity investments	(327)	(1,538)	2,130
Other	701	870	435
Total noninterest income	9,641	7,690	8,843
NONINTEREST EXPENSE			
Salaries	4,383	4,027	3,652
Incentive compensation	1,706	1,195	846
Employee benefits	1,283	960	989
Equipment	1,014	909	948
Net occupancy	1,102	975	953
Goodwill	--	610	530
Core deposit intangibles	155	165	186
Net losses (gains) on dispositions of premises and equipment	52	(21)	(58)
Other	4,214	4,071	3,784
Total noninterest expense	13,909	12,891	11,830
INCOME BEFORE INCOME TAX EXPENSE AND EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	8,854	5,479	6,549
Income tax expense	3,144	2,056	2,523
NET INCOME BEFORE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	5,710	3,423	4,026
Cumulative effect of change in accounting principle	(276)	--	--
NET INCOME	\$5,434	\$3,423	\$4,026
NET INCOME APPLICABLE TO COMMON STOCK	\$5,430	\$3,409	\$4,009
EARNINGS PER COMMON SHARE			
Earnings per common share	\$ 3.19	\$ 1.99	\$ 2.36
Diluted earnings per common share	\$ 3.16	\$ 1.97	\$ 2.33
DIVIDENDS DECLARED PER COMMON SHARE	\$ 1.10	\$ 1.00	\$.90
Average common shares outstanding	1,701.1	1,709.5	1,699.5
Diluted average common shares outstanding	1,718.0	1,726.9	1,718.4

Source: Wells Fargo & Company Annual Report, 2002, p. 60.

Exhibit 3 Wells Fargo & Company—Consolidated Balance Sheet

(in millions, except shares)	December 31,	
	2002	2001
ASSETS		
Cash and due from banks	\$ 17,820	\$ 16,968
Federal funds sold and securities purchased under resale agreements	3,174	2,530
Securities available for sale	27,947	40,308
Mortgages held for sale	51,154	30,405
Loans held for sale	6,665	4,745
Loans	196,634	172,499
Allowance for loan losses	3,862	3,761
Net loans	192,772	168,738
Mortgage servicing rights	4,489	6,241
Premises and equipment, net	3,688	3,549
Core deposit intangibles	868	1,013
Goodwill	9,753	9,527
Other assets	30,929	23,545
Total assets	\$349,259	\$307,569
LIABILITIES		
Noninterest-bearing deposits	\$ 74,094	\$ 65,362
Interest-bearing deposits	142,822	121,904
Total deposits	216,916	187,266
Short-term borrowings	33,446	37,782
Accrued expenses and other liabilities	18,334	16,777
Long-term debt	47,320	36,095
Guaranteed preferred beneficial interests in Company's subordinated debentures	2,885	2,435
STOCKHOLDERS' EQUITY		
Preferred stock	251	218
Unearned ESOP shares	(190)	(154)
Total preferred stock	61	64
Common stock- \$1 ² / ₃ par value, authorized 6,000,000,000 shares; issued 1,736,381,025 shares	2,894	2,894
Additional paid-in capital	9,498	9,436
Retained earnings	19,394	16,005
Cumulative other comprehensive income	976	752
Treasury stock—50,474,518 shares and 40,886,028 shares	(2,465)	(1,937)
Total stockholders' equity	30,358	27,214
Total liabilities and stockholders' equity	\$349,259	\$307,569

Source: Wells Fargo & Company Annual Report 2002, p. 61.

Exhibit 4 Wells Fargo & Company—Consolidated Statement of Cash Flows

(in millions)	Year Ended December 31,		
	2002	2001	2000
Cash flows from operating activities:			
Net income	\$ 5,434	\$ 3,423	\$ 4,026
Adjustments to reconcile net income to net cash (used) provided by operating activities:			
Provision for loan losses	1,733	1,780	1,329
Depreciation and amortization	3,495	2,961	1,790
Net (gains) losses on securities available for sale	(198)	726	(1,133)
Net gains on mortgage loan origination/sales activities	(1,038)	(705)	(38)
Net (gains) losses on sales of loans	(19)	(35)	134
Net losses (gains) on dispositions of premises and equipment	52	(21)	(58)
Net gains on dispositions of operations	(10)	(122)	(23)
Release of preferred shares to ESOP	206	159	128
Net increase in trading assets	(3,859)	(1,219)	(1,087)
Net increase (decrease) in deferred income taxes	305	(589)	873
Net decrease (increase) in accrued interest receivable	145	232	(230)
Net (decrease) increase in accrued interest payable	(53)	(269)	290
Originations of mortgages held for sale	(286,100)	(179,475)	(62,095)
Proceeds from sales of mortgages held for sale	265,028	157,884	62,873
Principal collected on mortgages held for sale	2,063	1,731	1,731
Net increase in loans held for sale	(1,091)	(206)	(1,498)
Other assets, net	(2,000)	(956)	(3,791)
Other accrued expenses and liabilities, net	1,929	5,082	4,149
Net cash (used) provided by operating activities	(13,978)	(9,619)	7,370
Cash flows from investing activities:			
Securities available for sale:			
Proceeds from sales	11,863	19,586	23,624
Proceeds from prepayments and maturities	9,684	6,730	6,247
Purchases	(7,261)	(29,053)	(19,770)
Net cash (paid for) acquired from acquisitions	(588)	(459)	469
Net increase in banking subsidiaries' loans resulting from originations and collections	(17,745)	(11,596)	(36,076)
Proceeds from sales (including participations) of banking subsidiaries' loans	948	2,305	11,898
Purchases (including participations) of loans by banking subsidiaries	(2,818)	(1,104)	(409)
Principal collected on nonblank subsidiaries' loans	11,396	9,964	8,305
Nonbank subsidiaries' loans originated	(14,621)	(11,651)	(9,300)
Proceeds from dispositions of operations	94	1,191	13
Proceeds from sales of foreclosed assets	473	279	255
Net (increase) decrease in federal funds sold and securities purchased under resale agreements	(475)	(932)	124
Net increase in mortgage servicing rights	(1,259)	(3,405)	(1,460)
Other, net	(2,646)	(1,095)	6,489
Net cash used by investing activities	(12,955)	(19,240)	22,569

(in millions)	Year Ended December 31,		
	2002	2001	2000
Cash flows from financing activities:			
Net increase in deposits	25,050	17,707	20,745
Net (decrease) increase in short-term borrowings	(5,224)	8,793	(3,511)
Proceeds from issuance of long-term debt	21,711	14,658	15,544
Repayment of long-term debt	(10,902)	(10,625)	(9,849)
Proceeds from issuance of guaranteed preferred beneficial interests in Company's subordinated debentures	450	1,500	--
Proceeds from issuance of common stock	578	484	422
Redemption of preferred stock	--	(200)	--
Repurchase of common stock	(2,033)	(1,760)	(3,238)
Payment of cash dividends on preferred and common stock	(1,877)	(1,724)	(1,586)
Other, net	32	16	(468)
Net cash provided by financing activities	27,785	28,849	18,059
Net change in cash and due from banks	852	(10)	2,860
Cash and due from banks at beginning of year	16,968	16,978	14,118
Cash and due from banks at end of year	\$17,820	\$16,968	\$16,978
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 3,924	\$ 6,472	\$ 8,150
Income taxes	\$ 2,789	\$ 2,552	\$ 817
Noncash investing and financing activities:			
Net transfers between mortgages held for sale and loans	\$ 439	\$ 1,230	\$ 129
Net transfers between loans held for sale and loans	\$ 829	\$ --	\$ 1,388
Transfers from loans to foreclosed assets	\$ 491	\$ 325	\$ 189

Source: Wells Fargo & Company Annual Report 2002, p. 63.

Exhibit 5 Wells Fargo Long-Term Debt Schedule

The following is a summary of long-term debt (reflecting unamortized debt discounts and premiums, where applicable) owed by the Parent and its subsidiaries:

(in millions)	Maturity Date(s)	Interest Rate(s)	2002	2001
Wells Fargo & Company (Parent only)				
Senior				
Global Notes ^a	2003–2007	3.75–7.25%	\$ 6,545	\$ 4,996
Global Notes	2004	Various	2,000	1,250
Medium-Term Notes ^a	2003–2006	4.80–6.875%	1,847	1,596
Medium-Term Notes	2003–2027	3.375–7.65%	1,546	1,670
Floating-Rate Medium-Term Notes	2003–2005	Various	2,150	2,300
Extendable Notes ^b	2004	Various	2,998	1,497
Equity Linked Notes ^{a,c}	2008	2.778–2.836%	79	--
Notes	2004	6.00%	1	1
Total senior debt			17,166	13,310
Subordinated				
Global Notes ^a	2011–2014	5.00–6.375%	1,588	748
Global Notes	2012	4.00–5.125%	795	--
Notes ^a	2003	6.625%	200	200
Debentures	2023	6.65%	198	198
Total subordinated debt			2,781	1,146
Total long-term debt—Parent			19,947	14,456
WFC Holdings Corporation				
Senior				
Medium-Term Notes ^a	2002	10.00%	--	2
Medium-Term Notes	2002	9.04–10.00%	--	2
Total senior debt			--	4
Subordinated				
Medium-Term Notes ^{a,d}	2013	6.50%	25	50
Medium-Term Notes	2002	9.375%	--	30
Notes	2003	6.125–6.875%	399	732
Notes ^a	2004–2006	6.875–9.125%	933	933
Notes ^{a,d}	2008	6.25%	199	199
Total subordinated debt			1,556	1,944
Total long-term debt -WFC Holdings			1,556	1,948
Wells Fargo Financial, Inc. and its subsidiaries (WFFI)^e				
Senior				
Medium-Term Notes	2003–2012	5.10–7.47%	956	801
Floating-Rate Notes	2003–2005	Various	1,100	950
Notes	2003–2015	4.875–8.56%	6,678	6,395
Total long-term debt –WFFI			8,734	8,146
First Security Corporation and its subsidiaries (FSCO)				
Senior				
Medium-Term Notes	2003	6.40%	15	15
Floating-Rate Euro Medium-Term Notes ^f	2002	Various	--	300
Floating-Rate Euro Medium-Term Notes	2003	Various	285	285
Federal Home Loan Bank (FHLB) Notes and Advances ^g	2003–2010	3.00–6.47%	151	351
Floating-Rate FHLB Advances ^g	2003	Various	100	--
Notes	2003–2006	5.875–6.875%	474	473
Other notes ^h	2002–2007		--	3
Total senior debt			1,025	1,427
Subordinated				
Notes ^a	2005–2006	7.00–7.31 %	159	234

(in millions)	Maturity Date(s)	Interest Rate(s)	2002	2001
Total subordinated debt			159	234
Total long-term debt—FSCO			1,184	1,661
Wells Fargo Bank, N.A. (WFB, N.A.)				
Senior				
Floating-Rate Bank Notes	2003	Various	\$ 4,005	\$ 1,525
Floating-Rate Notes ⁱ	2007	Various	1,250	--
Notes payable by subsidiaries	2003–2009	8.25–17.87%	49	52
Other notes	2002–2007		--	3
Obligations of subsidiaries under capital leases			7	8
Total senior debt			5,311	1,588
Subordinated				
FixFloat Notes (callable 6/15/2005) ^a	2010	7.8% through 2005, various	997	997
Notes ^a	2010–2011	6.45–7.55%	2,497	2,496
Total subordinated debt			3,494	3,493
Total long-term debt –WFB,N.A.			8,805	5,081
Other consolidated subsidiaries				
Senior				
FHLB Notes and Advances ^g	2003–2027	3.15–8.38%	2,780	2,211
Floating-Rate FHLB Advances ^g	2003–2011	Various	4,065	2,334
Other notes and debentures	2003–2015	3.00–12.00%	150	239
Capital lease obligations			14	19
Total senior debt			7,009	4,803
Subordinated				
Other notes and debentures ^j	2005	7.55%	85	--
Total subordinated debt			85	--
Total long-term debt- other consolidated subsidiaries			7,094	4,803
Total consolidated long-term debt			\$47,320	\$36,095

Source: Wells Fargo & Company Annual Report 2002, p. 80.

^aThe company entered into interest rate swap agreements for substantially all of these notes, whereby the company receives fixed-rate interest payments approximately equal to interest on the notes and makes interest payments based on an average three-month or six-month LIBOR rate.

^bThe extendable notes are a floating rate security with an initial maturity of 13 months, which can be extended on a rolling basis, at the investor's option to a final maturity of five years.

^cZero coupon notes linked to the S&P 500 and Nasdaq-100 indices.

^dThe interest rate swap agreement for these notes is callable by the counterparty prior to the maturity of the notes.

^eOn October 22, 2002, WFFI announced that it will no longer issue term debt securities and the Parent issued a full and unconditional guarantee of all outstanding debt of WFFI.

^fThe company entered into an interest rate swap agreement for these notes, whereby the company receives interest payments based on an average three-month LIBOR rate and makes fixed-rate interest payments ranging from 5.625% to 5.65%.

^gThe maturities of the FHLB advances are determined quarterly, based on the outstanding balance, the then current LIBOR rate, and the maximum life of the advance. Advances maturing within the next year are expected to be refinanced, extending the maturity of such borrowings beyond one year.

^hThe notes are tied to low-income housing funding.

ⁱCallable by either the company or the investor upon 30 days notice.

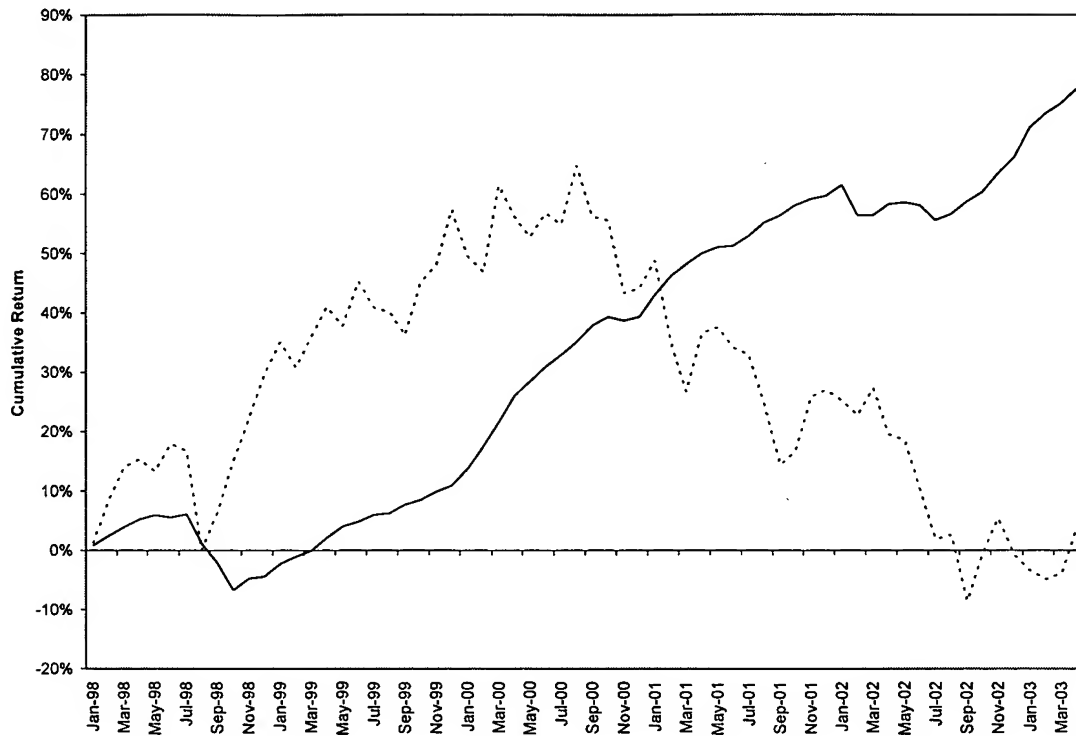
^jCallable by the company upon 30 days notice.

Exhibit 6 Wells Fargo Leverage Ratios Relative to Regulatory Requirements (in billions)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under the FDICIA Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2002:						
Total capital (to risk-weighted assets)						
Wells Fargo & Company	\$32.0	11.31%	≥\$22.6	≥8.00%		
Wells Fargo Bank, N.A.	17.9	11.42	≥ 12.5	≥8.00	≥\$15.7	≥10.00%
Wells Fargo Bank Minnesota, N.A.	4.0	13.50	≥ 2.3	≥8.00	≥ 2.9	≥10.00
Tier 1 capital (to risk-weighted assets)						
Wells Fargo & Company	\$21.5	7.60%	≥\$11.3	≥4.00%		
Wells Fargo Bank, N.A.	11.4	7.29	≥ 6.3	≥4.00	≥ \$9.4	≥ 6.00%
Wells Fargo Bank Minnesota, N.A.	3.7	12.53	≥ 1.2	≥4.00	≥ 1.8	≥ 6.00
Tier 1 capital (to average assets) (Leverage ratio)						
Wells Fargo & Company	\$21.5	6.58%	≥\$13.1	≥4.00% ^a		
Wells Fargo Bank, N.A.	11.4	6.84	≥ 6.7	≥4.00 ^a	≥ \$8.4	≥ 5.00%
Wells Fargo Bank Minnesota, N.A.	3.7	6.66	≥ 2.2	≥4.00 ^a	≥ 2.8	≥ 5.00

^aThe leverage ratio consists of Tier 1 capital divided by quarterly average total assets, excluding goodwill and certain other items. The minimum leverage ratio guideline is 3% for banking organizations that do not anticipate significant growth and that have well-diversified risk, excellent asset quality, high liquidity, good earnings, effective management and monitoring of market risk and, in general, are considered top-rated, strong banking organizations.

Source: Wells Fargo Annual Report, 2002, p. 104.

Exhibit 7 Convertible arbitrage (solid) versus US equities (dashed) returns, 1998-April 2003

Source: Adapted from CSFB Tremont Convertible Arbitrage Index returns and the Center for Research on Security Prices.

Exhibit 8 Selected Convertible Securities

Issue Date	Issuer	Proceeds Amount in this Market (\$ mil)	Type of Security	Description	Coupon (%)	Standard & Poor's Rating	Conversion Price	Conversion Shares per Bond	Share Price
01/16/2002	Continental Airlines	175	Cvt Senior Debts	4.500% Cvt Senior Debts due '07	4.5	NR	40.00	25.00	31.10
02/28/2002	General Motors	2,300	Convertible Dbs	5.250% Convertible Dbs due '32	5.25	BBB+	64.90	15.41	52.98
02/28/2002	General Motors	1,000	Convertible Dbs	4.500% Convertible Dbs due '32	4.5	BBB+	70.20	14.25	52.98
03/7/2002	Merrill Lynch	2,000	Sr COCO LYONS	Sr COCO LYONS due '32	Floats	AA-	72.35	13.82	52.79
03/21/2002	Travelers Property	850	Cvt Jr Sub Nts	4.500% Cvt Jr Sub Nts due '32	4.5	BBB	23.13	43.23	18.50
05/01/2002	Sonic Automotive	130	Cvt Subord Nts	5.250% Cvt Subord Nts due '09	5.25	B+	46.87	21.34	38.00
06/13/2002	Agere Systems	410	Cvt Subord Nts	6.500% Cvt Subord Nts due '09	6.5	B	3.31	302.34	2.45
07/01/2002	Mirant	370	Cvt Senior Nts	5.750% Cvt Senior Nts due '07	5.75	BBB-	7.58	131.93	7.30
10/16/2002	PMA Capital	75	Cvt Senior Debts	Cvt Senior Debts due '22	Floats	BBB-	16.37	61.09	12.40
11/19/2002	AMD	350	Cvt Senior Nts	4.500% Cvt Senior Nts due '07	4.5	CCC	7.37	135.69	5.58
12/23/2002	Interpool	31.1	CvtExchRdSubDeb	9.250% Perpetual CvtExchRdSubDeb	9.25	NR	25.00	40.00	17.32
01/07/2003	Tyco International	2,500	Convertible Dbs	2.750% Convertible Dbs due '18	2.75	BBB-	22.00	45.45	17.26
01/07/2003	Tyco International	1,250	Convertible Dbs	3.125% Convertible Dbs due '23	3.125	BBB-	21.00	47.62	17.26
02/19/2003	Affiliated Managers Group	250	Convertible Bds	Zero Con Convertible Bds due '33	Zero	BBB-	81.00	12.35	44.09
03/17/2003	Mandalay Resort Group	350	Convertible Bds	Convertible Bds due '33	Floats	BB+	57.00	17.54	28.50
3/25/2003	HCC Insurance Holdings	125	Cvt Senior Nts	1.300% Cvt Senior Nts due '23	1.3	A	33.97	29.44	25.31
04/08/2003	Walt Disney	1,150	Cvt Senior Nts	2.125% Cvt Senior Nts due '23	2.125	BBB+	29.46	33.94	17.13

Source: Adapted from SDC Platinum, a Thomson Financial product, accessed August 2005.

Exhibit 9 Selected Terms

Debentures Offered	\$3,000,000,000 principal amount of floating rate convertible senior debentures due 2033. The principal amount of each debenture is \$1,000.
Maturity	30 years (May 1, 2033)
Coupon	Interest paid at an annual rate equal to 3-month LIBOR minus 0.25%. Regular interest will be paid quarterly on February 1, May 1, August 1, and November 1 of each year until 2008.
Conversion Rights	Investors have the right to convert their debentures if the closing sale price of Wells Fargo common stock for at least 20 trading days in the last 30 consecutive trading days of any calendar quarter is more than 120% of the base conversion price (120% of \$100.00, or \$120.00).
Conversion Rate	<p>Before May 1, 2008, the "conversion rate" is: If the stock price is less than or equal to the base conversion price (\$100.00), the base conversion rate (10); or if the stock price is greater than the base conversion price, determined according to the following formula, not to exceed 21.0748:</p> $10 + [(Stock\ Price - 100) / Stock\ Price] \times 33.5$ <p>On May 1, 2008, the conversion rate will be fixed at the conversion rate determined as set forth above, assuming a conversion date that is eight trading days before May 1, 2008.</p>
Remarketing Reset Event	<p>A "remarketing reset event" occurs if the average of the closing prices of Wells Fargo common stock on the five trading days prior to May 1 of 2008, 2013, 2018, 2023, or 2028 is less than the base conversion price (\$100.00).</p> <p>If a remarketing reset event occurred: The debentures will no longer be convertible into common stock; Wells Fargo will no longer pay regular cash interest or contingent interest; The yield at which the principal amount of the debentures would accrete will be reset on such date and each May 1st thereafter until maturity to the reset yield determined on each on those dates, the "remarketing reset dates."</p>
Contingent Interest	Commencing with the interest period beginning May 1, 2008, Wells Fargo will pay "contingent interest" equal to a "payment factor" times the conversion rate, if a remarketing reset event has not occurred. The payment factor starts at \$0.44 on May 1, 2008 and rises \$0.02 every three quarters thereafter.
Redemption	Beginning on May 5, 2008, Wells Fargo may redeem the debentures for cash at any time, if a remarketing reset event has not occurred.
Reset Yield	The "reset yield" equals the yield necessary to enable the remarketing of the debentures at a price sufficient to provide net proceeds equal to the accreted principal amount.
Redemption of Debentures at Our Option	Before May 5, 2008, we may not redeem the debentures. Beginning on May 5, 2008, we may redeem the debentures for cash at any time as a whole, or from time to time in part. If a remarketing reset event occurs, we may no longer redeem the debentures. The redemption price of a debenture will be the accreted principal amount of such debenture on the redemption date, plus any accrued and unpaid interest, including contingent interest, to but excluding such date.

Source: Adapted from Wells Fargo & Company prospectus.

Exhibit 10 Interest rates in percentage points, April 25, 2003.

Maturity	Treasury Securities	Eurodollar Deposits	Interest Rate Swaps
1-month	1.13	1.25	
3-month	1.14	1.25	
6-month	1.17	1.23	
1-year	1.26		1.32
2-year	1.57		1.79
3-year	2.00		2.35
5-year	2.88		3.20
7-year	3.42		3.74
10-year	3.91		4.25
20-year	4.83		
30-year			5.07

Source: Federal Reserve Statistical Release, April 28, 2003.

Exhibit 11 Option prices on Wells Fargo stock, April 25, 2003.

Type	Exercise Date	Exercise Price	Best Bid	Best Offer	Open Interest	Volume
Put	17-May-03	47.5	1.05	1.2	920	130
Call	17-May-03	47.5	0.7	0.85	3301	61
Put	17-May-03	42.5	0.1	0.2	1199	50
Put	17-May-03	50	2.95	3.1	105	10
Call	17-May-03	50	0.05	0.15	3517	1
Put	21-Jun-03	45	0.75	0.85	672	150
Call	21-Jun-03	50	0.35	0.4	4398	63
Put	21-Jun-03	42.5	0.3	0.45	189	10
Call	21-Jun-03	47.5	1.3	1.4	1185	5
Put	19-Jul-03	45	1.15	1.25	4823	2010
Call	19-Jul-03	45	3.3	3.5	2795	102
Call	19-Jul-03	50	0.7	0.75	11584	38
Put	19-Jul-03	40	0.3	0.4	1441	10
Put	19-Jul-03	47.5	2.05	2.1	2711	6
Call	19-Jul-03	47.5	1.75	1.8	6363	5
Call	19-Jul-03	42.5	5.3	5.4	299	2
Call	18-Oct-03	50	1.5	1.65	5708	61
Call	18-Oct-03	55	0.4	0.45	8703	30
Put	18-Oct-03	47.5	3.1	3.2	851	15
Put	18-Oct-03	55	8.3	8.5	20	10
Call	18-Oct-03	45	4.1	4.3	1313	2
Put	17-Jan-04	40	1.4	1.5	23783	1020
Call	17-Jan-04	50	2.15	2.25	20744	704
Call	17-Jan-04	45	4.6	4.8	2763	226
Put	17-Jan-04	45	2.85	2.9	4562	226
Put	17-Jan-04	35	0.65	0.8	10776	150
Call	17-Jan-04	55	0.75	0.9	8085	38
Call	17-Jan-04	40	8.3	8.5	3351	4
Put	17-Jan-04	20	0	0.1	2828	1
Call	22-Jan-05	50	4.1	4.2	7444	20
Put	22-Jan-05	30	1	1.25	647	1

Source: Adapted from Option Metrics.

Exhibit 12 Convertible Bonds, League Table Rankings, January through April 2003

Underwriter	Number of Issues	Dollar Value (\$M)	Market Share (%)
Citigroup	57	17,219.6	18.6
Merrill Lynch & Co. Inc.	38	16,191.2	17.5
Goldman Sachs & Co	23	11,791.5	12.7
Credit Suisse First Boston	31	7,911.7	8.5
JP Morgan	24	7,013.8	7.6
Morgan Stanley	22	6,871.3	7.4
Deutsche Bank AG	14	4,708.8	5.1
UBS	20	4,272.7	4.6
Banc of America Securities	18	4,107.0	4.4
Societe Generale	12	2,987.9	3.2
Lehman Brothers	9	2,290.1	2.5
BNP Paribas SA	6	1,949.6	2.1
Nomura	8	1,073.8	1.2
All Others	28	3,404.3	3.5
Total	251	92,733.8	100

Note: Deal allocation was "full to book manager, full if joint books." The full amount of a transaction was given as credit to all book managers on the transaction. For example, if two underwriters were joint book managers on a \$100 million transaction, they would both receive \$100 million credit for the transaction.

Source: Adapted from Thomson Financial.